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REGIONAL ECONOMICS
& MARKET STRATEGY MONTHLY

May-June 2016

Bulgaria | Cyprus | Romania | Serbia

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The authors wish to thank Dr. Tasos Anastasatos, Deputy Chief Economist, for his insightful comments

Regional Q1-2016 GDP estimates confirmed a good start in the year

REGIONAL MACROECONOMIC DEVELOPMENTS & OUTLOOK

- **Q1-2016 second GDP estimates** confirmed a good start in the year
- **Lax monetary policies** together with sustained low world energy prices continue to provide a positive boost on **growth momentum** throughout 2016
- Strong **retail trade confidence** data improvement in the region

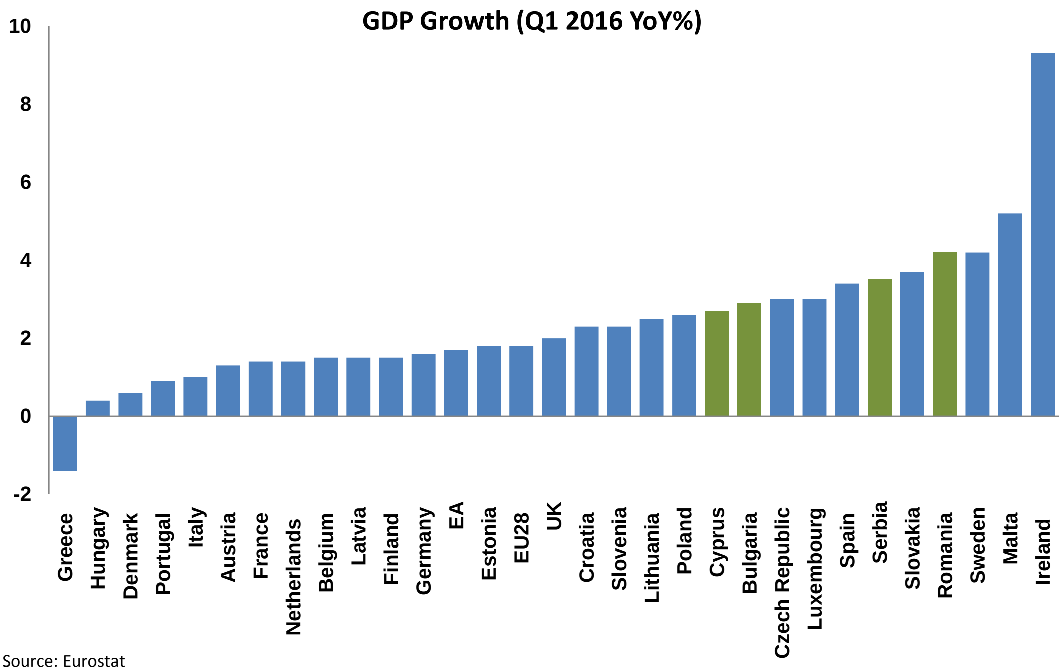
REGIONAL MARKET DEVELOPMENTS & OUTLOOK

- Investor sentiment is being constrained by the looming UK referendum
- **Most CESEE currencies** also lost ground, with idiosyncratic factors also at play
- The UK's referendum takes centre stage in June

COUNTRY FOCUS

- **Bulgaria:** Strong growth momentum sustained in Q1-2016
- **Cyprus:** Parliamentary elections result in a more fragmented new parliament
- **Romania:** Stronger than expected Q1-2016 GDP estimate
- **Serbia:** Economic activity picks up further pace, led by investments and exports

Regional strong growth momentum sustained in Q1-2016



Source: Eurostat

Contents

I. Regional Macroeconomic Developments & Outlook

Q1-2016 GDP readings confirmed a good start in the year for the region

OECD and WB lowered their forecasts on world GDP growth giving a fresh rise to concerns on sluggish global growth; yet, regional prospects remain intact

In the past month, the stronger than expected EA Q1 GDP second estimate (+0.6% QoQ/+1.7% YoY), the unexpectedly very weak US labor May data, plus the ongoing rally of oil prices, which surpassed the 50$ threshold, were among the major news that have helped risk-taking sentiment. However, OECD and World Bank lowered their forecasts on world GDP growth, giving a fresh rise to concerns on sluggish global growth. To that end, OECD now sees world GDP growth at 3% in 2016, unchanged from 2015, at 3.3% in 2017, while the 34 country OECD area is projected to grow by only 1.8% in 2016 and 2.2% in 2017. Against this unfavorable external backdrop, the region's prospects in 2016 have remained once again relatively unscathed.

The second GDP estimates of Q1-2016 released earlier this month serve as a fresh reminder that there are few winners' economies in the EM space

A number of national statistics offices across the region released earlier this month second estimates of GDP growth for Q1-2016 that confirmed the previous flash GDP estimates. Among them, three economies of our focus Bulgaria, Romania, Cyprus and earlier this month Serbia published already a more bullish than expected estimate. Vindicating our and market expectations, those readings overall confirmed a good start in the year. Now that the detailed break-down for all the economies is available, it would be fair to say that domestic demand was in the driver's seat behind growth in Q1. Lax monetary policies together with much lower world energy prices -on an annual basis despite their recent rally in the last couple of months- continue to provide a positive boost on the growth momentum. Although this boost is destined to eventually fade away as energy prices normalize, it is poised to carry throughout 2016 as well; low energy costs keep inflation pressures subdued, supporting real disposable incomes and providing more flexibility to household, corporate, and sovereign balance sheets. The economic sentiment data published in May were on average lower for the region than in April. With one observation missing, the ESI index has overall retrenched to relatively lower levels in Q2, predisposing for a mildly slower growth compared to Q1. Nevertheless, consumer sentiment and services remain close to their previous recorded peaks and above their long-term average. In addition, retail trade confidence has improved as consumers continue to benefit from rising real wages, firmer labor markets and low inflation. To that end, the ESI index of June plus a number of high frequency indicators is expected to shed more light and help us understand the dynamics of economic activity better.

Cyprus impressed once again expanding at +2.7% YoY in Q1-2016. The reading is the fifth consecutive quarter on both quarterly and an annual basis.

At a country level, the second reading confirmed that **Bulgaria** expanded by +2.9% YoY in Q1. Private consumption was the main growth driver this quarter, complemented by net exports. Rising real wages, the improving consumer and business sentiment trend, lower on an annual basis energy prices -Bulgaria has the highest energy consumption intensity in EU-28- and further gains in employment were among the principal drivers of the spending recovery. **Cyprus** expanded by +0.9% QoQ/+2.7% YoY in Q1 driven by consumption. The annual growth reading was the fifth consecutive positive one on both a quarterly and an annual basis after a three year recession in 2012-14. Ceteris paribus, FY growth is poised to gain momentum to 2.5% in 2016 vs. 1.6% in 2015, above any recent international organizations' forecast, underpinned by strong sentiment improvement, a flourishing tourism sector and lower unemployment. Even though parliamentary elections were not a game changer, it is imperative that the reform momentum and prudent macroeconomic policies continue in order to avoid a backtracking of the economy.

Serbia expanded by +3.5% YoY in Q1-2016, the highest rate since Q4-2013, driven primarily by investments

In **Romania**, GDP growth expanded by +1.6% QoQ/+4.2% YoY in Q1-2016. Yet, strong growth dynamics are largely driven by domestic demand, especially private consumption, and financed by the expansionary fiscal policy at the expense of pushing government finances off consolidation track against repeated IMF & EU advice. In **Serbia**, the positive dynamics of high-frequency indicators were mirrored in the GDP estimate of Q1-2016 as well, which was confirmed at +3.5%YoY. The reading marks the highest annual rate of increase since Q4-2013, prompting us to revise upwards the FY estimate to 2% in 2016, up from 0.7% in 2015. Investments, especially public sector spending, in spite of the ongoing fiscal consolidation, and net exports remain the main drivers of growth. Elsewhere, the formation of an SNS-led government cabinet is still pending more than a month after the elections.

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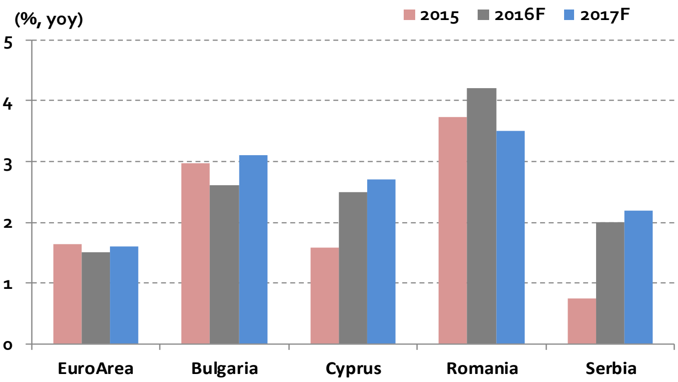
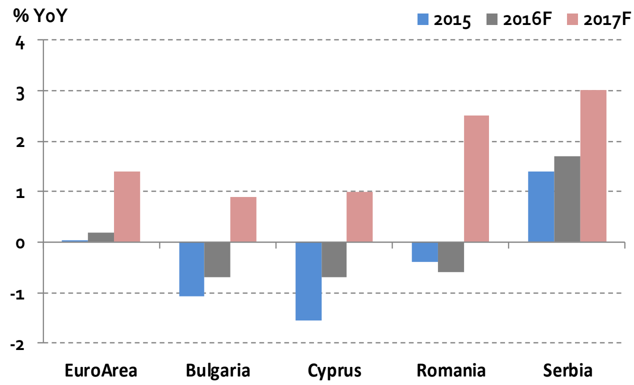
FIGURE 1: **GDP Growth performance 2015-2017**



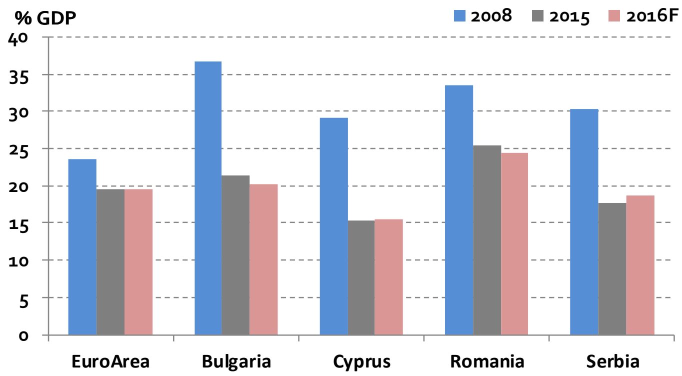
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 2: **Annual average HICP inflation 2015- 2017**



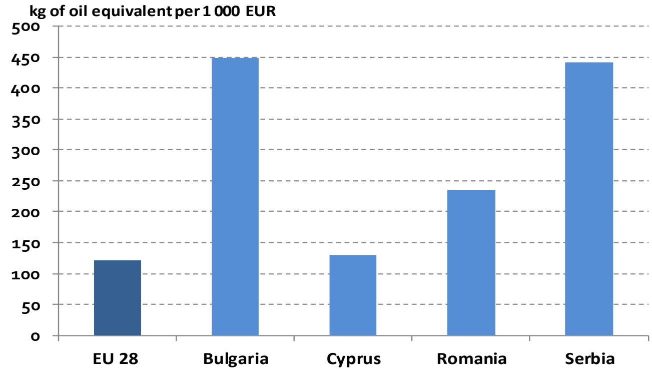
Source: Eurostat, EU Spring Forecasts, Eurobank Research

FIGURE 3: **Investments to GDP ratios 2008 vs. 2014**



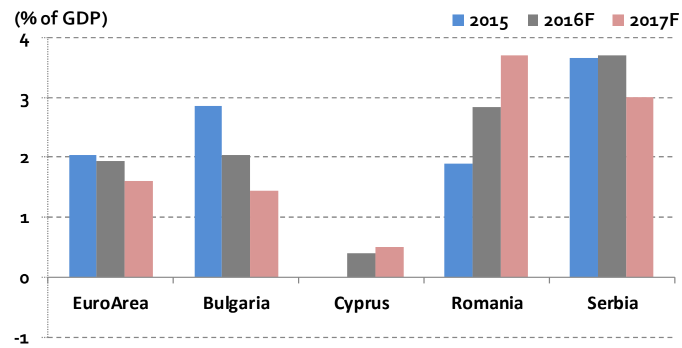
Source: IMF WEO, Eurobank Research

FIGURE 4: **Energy intensity of the individual countries, 2014**



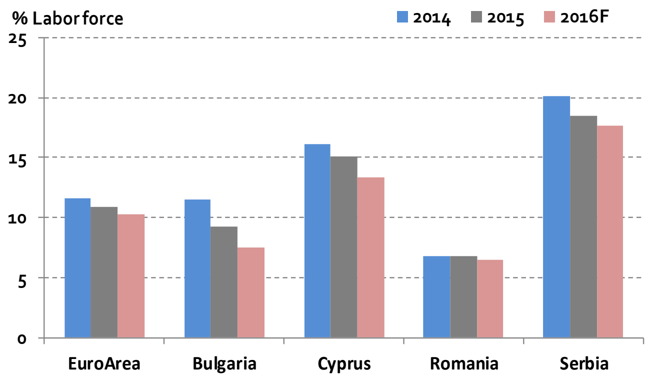
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 5: **Fiscal Balance (% of GDP, Cash basis) 2015- 2017**



Source: Eurostat, National Authorities, Eurobank Research

FIGURE 6: **Annual average unemployment rates 2014-2016**



Source: Eurostat, National Authorities Eurobank Research

II. Regional Market Developments & Outlook

Investor sentiment is being constrained by looming UK referendum

Emerging Market assets came under renewed pressure in early June

Following a rally since late May, Emerging Market assets came under renewed pressure earlier in June, as investor sentiment is being constrained by the looming UK referendum on the country's EU membership later this month. In this context, the euphoria stirred in the aftermath of a dovish shift in short-term Fed rate hike expectations prompted by an unexpectedly weak US May non-farm payrolls report, seems to have evaporated. Reflecting this latest bout of increased risk aversion, the Chicago Board Options Exchange Volatility Index (VIX) index spiked to a 3 ½ month peak above 22 points on June 14. On the same day, emerging sovereign debt spreads over USTs on the EMBI+ index rose to a 2-month high near 407bps and the 10-year German Bund yield slid to below zero for the first time on record. Presently, recent developments favoring EMs, such expectations of a "lower for longer" Fed, improved near-term economic growth prospects in China and a rise in commodity prices to a multi-month peak above $50bbl have moved to the backseat.

CESEE assets most sensitive to recent Brexit-related downtrend

Along these lines, the MSCI Emerging Markets index stood in mid-June ca 5% lower from a 1 ½-month peak near 845 points achieved about a week earlier. CESEE bourses appear to have borne the brunt of the recent Brexit-related downtrend as they are more closely (directly or indirectly) related to the EU, in terms of financial, economic and political links. As a consequence, the MSCI Emerging Europe and Eastern Europe indices have fared worse than most other EM peers, having sold off by approximately 8% each over the same time span. Idiosyncratic factors in the CESEE region have also been at play, denting further any support provided by comparably better fundamentals than other EM peers over recent months. Domestic political jitters in Turkey and worries over the government's policies in Poland have additionally weighed on both countries' indices. On the other hand, regional bourses have largely fared better. Bulgaria's SOFIX bucked the negative EM trend leading the gains with a spike to a 5-month high on June 15, while Serbia's BELEX15 and Romania's BET indices stood in a modestly positive territory compared to their levels about 1 ½ months ago.

CESEE currencies also lost ground, with idiosyncratic factors also at play

Most CESEE currencies also lost ground in this latest bout of mounting risk aversion. A continuation of ultra-accommodative Central Bank monetary policies does not favor either. The Turkish lira remains under pressure despite the appointment of new Prime Minister and AKP leader Binali Yildirim after his predecessor's (Davutoglou) surprise resignation announcement in early May. Although the new Premier swiftly reshuffled his cabinet and left largely unchanged the prior administration's economic team, the new government appears to have placed high on the agenda constitutional changes while economic reforms were put at the backburner. Recent incidents of domestic terrorism also bode ill for the Turkish currency, as does the prospect of renewed monetary easing, despite above-target inflation, in view of persisting pressures from the political landscape. In mid-June, the Polish zloty and the Hungarian forint touched 3-week lows near 4.4440 and 314.70 against the euro, while their corresponding implied volatilities remained close to recent 4-year and 8 ½ month highs, suggesting market expectations for further volatility in the CESEE currency markets ahead. Separately, the Romanian leu reached 4 ½ month lows vs. the euro in mid-June amid concerns that the upper house of parliament may vote to cut social security contributions in 2017 adding to worries about deteriorating fiscal balances. In line with its recent stance, the Serbian dinar continues to trade in a tight range, as the Central Bank continues to repeatedly intervene in the markets in order to cushion FX fluctuations. Elsewhere, the majority of CESEE local-currency government bonds have presented a rather mixed picture since the end of April. Serbian paper continues to outperform with the yield of the 10% May 2022 T-Note sliding by ca 105bps in mid-June to a new record low below 6%. Romanian and Hungarian paper also retained a relatively firm tone, while Turkish and Polish T-bonds lost ground.

The UK's referendum takes centre stage in June

Several global risk events feature high on the agenda in June and are highly concentrated in Europe. As long as uncertainty surrounding these lingers, emerging market assets are likely to remain in a consolidation phase. The Brexit referendum takes centre stage on June 23rd, with recent polls suggesting that the outcome is too close to call. Should the "remain" campaign win a relief rally in risky assets is likely to follow. The opposite result is likely to lead to more acute downside pressures, especially on European developing economies, as it does not seem to have been adequately priced in by financial markets. A few days later, on June 26th, Spain's repeat general elections follow. Meanwhile, US economic activity data releases remain in the forefront, as investors seek for potential indications of future Fed direction. Chinese macro will also continue to be closely scrutinized by market participants for any signs of stabilization of the world's second largest economy.

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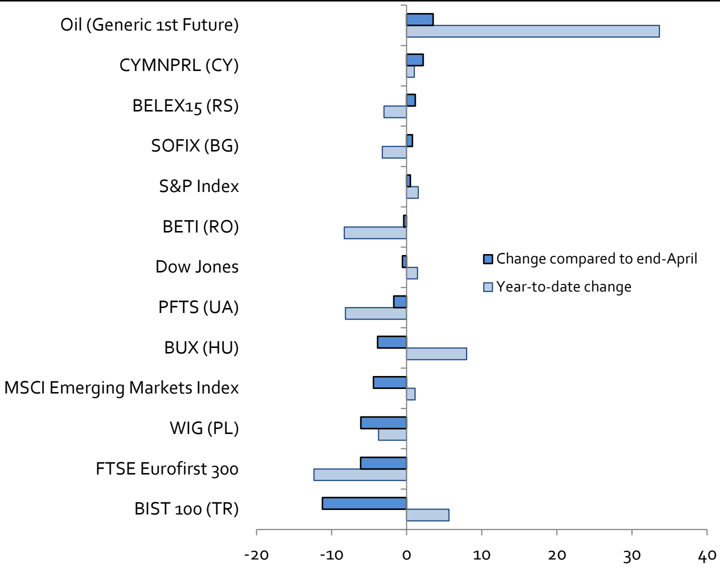
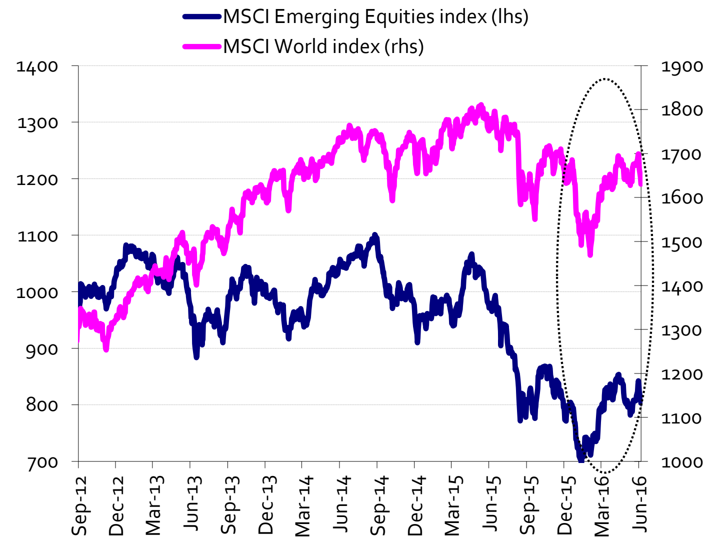
FIGURE 7: **Major world & CESEE stock markets performance (%)**



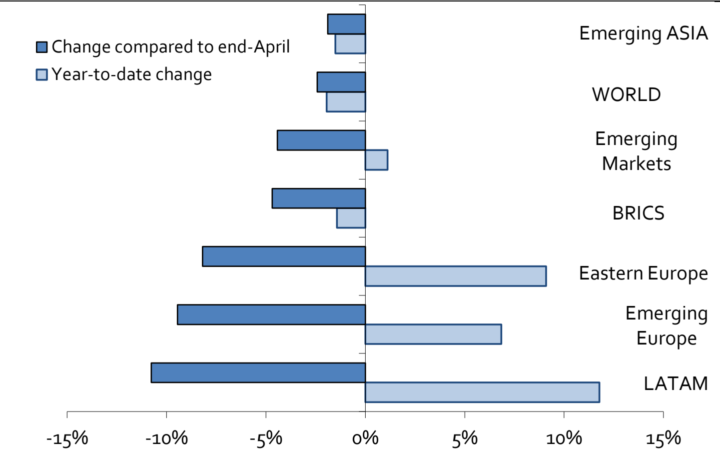
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 8: **World & EM stock markets performance**



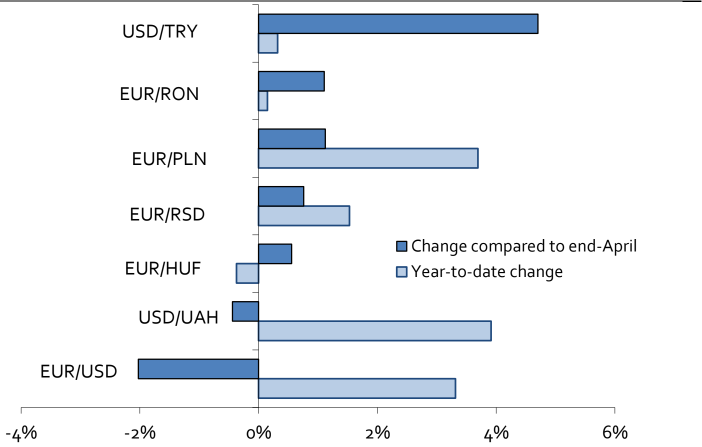
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 9: **MSCI stock indices performance (by region)**



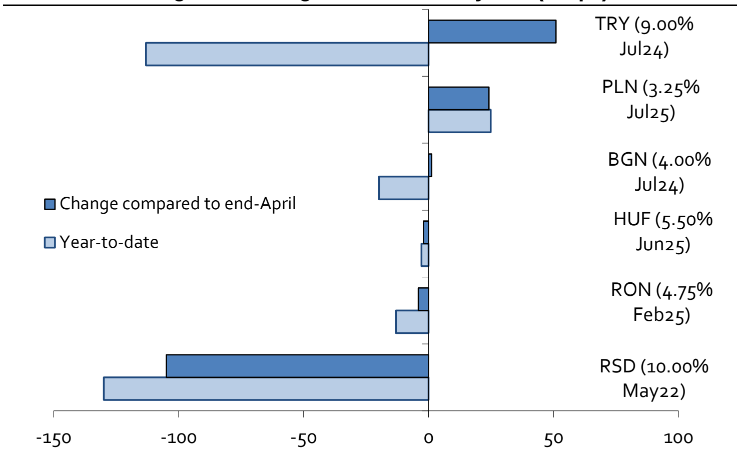
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 10: **CESEE FX performance**



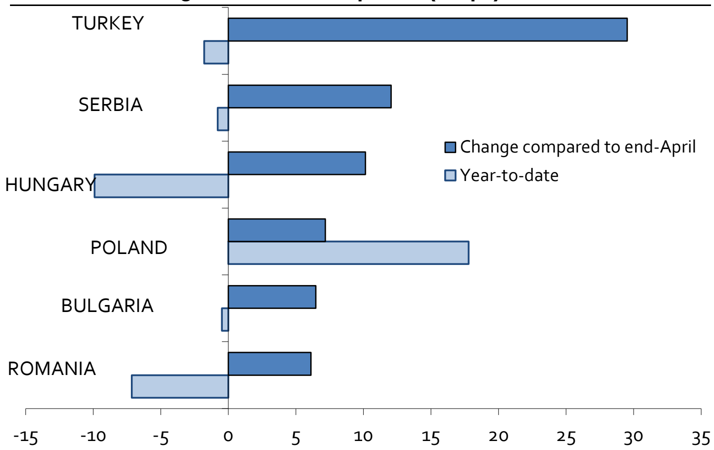
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 11: **Change in CESEE government bond yields (in bps)**



Source: Reuters, Bloomberg, Eurobank Research

FIGURE 12: **Change in 5-Year CDS spreads (in bps)**



Source: Reuters, Bloomberg, Eurobank Research

Trader's view

Long EUR/RSD positions at a 3-5 month period currently appear appealing

FX

The EUR/RSD finally escaped from a trading range 122.50-123.00 held for 2 ½ months, breaching the upper bound in late May and comfortably moving within the 123.40-50 area. The reason behind this move has been the Central Bank's reduced interference in the FX markets after the broadly anticipated outcome at the general elections in late April which significantly alleviated domestic political risks. Moving on, seasonal factors, such as weak EUR demand during the summer period, prompts us to believe that the dinar may recover some ground over the next two months with the pair likely to consolidate around 123.00 – 124.00, before the RSD comes under renewed pressure in September-December as has been the traditional pattern over recent years. Barring any major NBS surprises, the cross could rise towards 124.50 -125.00 (roughly 2.5% depreciation YtD) after the summer.

Security	Position	Entry	Target	Stop loss
EUR/RSD	Long ↑	123.25	124.50	122.45

Yields likely to move slightly downwards over the next month or so

Local rates

The Bulgarian local bonds yield curve remained mostly unchanged over the last month or so, as investors stayed on the sidelines mainly because of the long public holidays in the country. The most attractive part of the curve proved to be the 10-year sector, which was well supported and eased by 10 bps on monthly basis. In fact, the finance ministry successfully re-tapped the 10-year benchmark placing another BGN 100mn on May 16th. Solid investor demand was reflected by a bid/cover ratio of 2.33, while the average accepted yield fell to 2.41% against 2.58% earlier in January. The auction calendar is likely to remain empty in June with approximately BGN 900mn scheduled to be placed until the end of the year. In addition to the scarce supply on primary market, extra-liquidity and negative rates are also expected to provide support and push yields slightly downwards over the next month or so.

We remain constructive on our earlier long position on Serbian 3Y government paper

In Serbia, we remain constructive on our earlier long position on Serbian 3Y government paper in view of the recent rescaling in market expectations of Fed rate tightening and ongoing ECB QE support. Additionally, "Brexit" fears may eventually prove positive for the Serbian securities, sending investors from peripheral EU members countries to peripheral European/non EU countries.

Security	Position	Entry	Target	Stop loss	P&L (MtM+carry)
RSMFRSD	Long ↑	5.25%	4.75%	5.50%	1.82% (MtM 0.90 + 0.92 Carry)

Long Bulgaria Eurobond 2023 T-Note position remains favorable

External debt markets

The Bulgarian Eurobond curve slowly steepened over recent weeks as yields of paper with maturity of more than 10 years slightly increased while those of short and mid-end remained relatively well-bid. The yields of the new 23's and 28's bonds are currently trading 18 and 36 bps lower since issuance in March, respectively. We do not expect any notable re-pricing of the curve in the next month and continue to favour our earlier long recommendation on the 2023 Eurobond, which is in the money, in view of the country's improving fiscal position.

Security	Position	Entry	Current level	Target	Stop loss
BGARIA 2023	Long ↑	2.06%	1.98%	1.90%	2.20%

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We would also like to thank Costas Katsileros for his most valuable comments on the Regional Market Developments & Outlook

III. Country Focus
Bulgaria (Baa2/BB+/BBB-)

Strong growth momentum sustained in Q1-2016

Strong growth momentum was sustained in the first quarter of the year

The revised estimate of the NSI on the seasonally adjusted Q1-2016 GDP reading confirmed the flash estimate of +0.7% QoQ/+2.9% YoY. The strong reading of Q1 maintains the healthy performance in previous quarters (+3.0% YoY in Q4-2015, +3.1% YoY in Q3-2015, +2.9% YoY in Q1-2015). From a demand point of view, final consumption expanded by +0.4% QoQ/+2.1% YoY in Q1-2016, up from +1.8% YoY in Q4-2015 and -0.7% YoY in Q1-2015, thereby making a strong positive contribution (+1.7pps in Q1-2016 vs. +1.4pps in Q4-2015). Rising real wages, the improving consumer and business sentiment trend, lower energy prices on an annual basis -Bulgaria has the highest energy consumption intensity in EU-28- and further gains in employment were among the principal drivers of the spending recovery. The improvement of labor market conditions in 2015 and further in Q1-2016 has set the foundations for consumption to have a bigger weight on this year's growth in Bulgaria. Unemployment has declined to 7.3% in March and further to 7.1% in April, from 10.0% a year ago, as the economy adds more jobs in the labor-intensive areas of specialized services. From a sectoral point of view, professional (+6.2% YoY) and financial services (+6.9% YoY) were among the most dynamic in Q1-2016.

Investments were in red after three consecutive positive readings on lower EU funds and public investment spending

On the negative side, investments entered negative territory after three consecutive positive readings. Gross fixed capital formation contracted by -3.6% QoQ/-3.9% YoY in Q1-2016, down from +1.1% YoY in Q4-2015 and +1.4% YoY in Q3-2015. To some extent, the decline mirrors the negative base effects as a result of the increased EU funds absorption in the past year ahead of the closing of the programming period 2007-2013, as well as the fact that public investment spending is traditionally skewed to the last quarter of the year. Exports decelerated sharply to +0.0% QoQ/+0.3% YoY in Q1-2016 vs. +6.1% YoY in Q4-2015, despite the good performance of the Euroarea, the main trade partner of Bulgaria. Therefore, the contribution of net exports turned out less positive than in previous quarters (+1pps in Q1 vs. +1.2pps in Q4) but still not a drag on growth as imports decelerated faster(-1.2% QoQ/-1.3% YoY in Q1-2016 vs. +4.1% YoY in Q4). Overall, the strong growth momentum was sustained in Q1. Yet, our GDP forecast still stands at 2.6% in 2016 as we see downside risks for growth stemming primarily from lower EU funds absorption mirroring the beginning of the new multi-annual EU budgeting program period, a lower than last year's fiscal policy impulse and rising external environment headwinds for exporters.

Consumer prices dipped even lower in April

Inflation printed at 0% MoM/-2.2% YoY in April compared to -0.7% MoM/-1.5% YoY in March. As a result, the average annual inflation in the past twelve months came at -0.4% YoY. Food prices, both the largest as well as the most volatile component of CPI, made the largest negative contribution both on a monthly and an annual basis, driven by lower prices for vegetables and meat on an annual basis. Food prices came at -0.1% MoM/-2.7% YoY in April vs. -0.9% MoM/-1.3% YoY in March. Driven by lower world energy prices on an annual basis, transportation prices plunged by +0.0% MoM/-10.9% YoY in April compared to -1.7% MoM/-10.7% YoY in March. Consumer prices ought to recover in the 2H-2016 provided domestic demand dynamics become healthier, and deflationary pressures from the energy component subside as a result of the normalization of global prices. On the other hand, regulatory prices' adjustment in the energy sector pose a downside risk to an already lower than previously expected inflation outlook.

The budget execution in the first five months of the year is heavily influenced by EU funds reimbursements of the past year .

According to the preliminary data of the Ministry of Finance, the consolidated budget surplus came at BGN2.68bn or 3.0% of projected GDP in the first five months of the year, compared to a budget surplus of BGN1.09bn or 1.3% of GDP in the same period last year. Total revenues slowed down to +7.0% YoY in Jan-May, after soaring by +26.7% YoY in January only, reaching 44.9% of the annual target, driven primarily by higher reimbursements for EU-funded projects and higher excise duties for tobacco and fuel products. On the other hand, total expenditure declined by -5.0% YoY in Jan-May, reaching 34.9% of the annual target in Jan-May, which is most probably explained by lower capital expenditures spending and given that government spending -particularly its EU-funded part- is skewed to the end of the year. The consolidated government deficit target on a cash basis is set at 2.0% of GDP in 2016, down from a realized 2.9% in 2015. Although the headline number implies significant consolidation effort, the government anticipates improved revenues from EU reimbursements for spending in the past year, concession revenues from the Sofia airport, while additional buffers could emerge from higher than last year's budget flexibility on the discretionary spending side.

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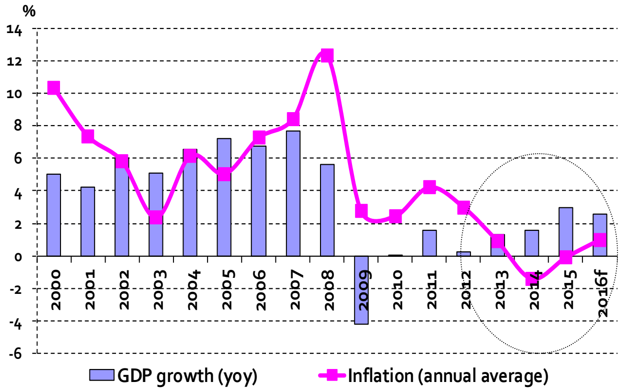
Bulgaria: Macro & Market Data				
	2014	2015	2016f	2017f
Real GDP (yoy%)	1.6	3.0	2.6	3.0
Inflation (yoy%)				
CPI (annual average)	-1.4	-0.1	-0.5	1.2
CPI (end of period)	-0.9	-0.4	0.0	1.5
Fiscal Accounts (%GDP)				
General Government Balance	-3.7	-2.9	-2.0	-1.4
Gross Public Debt	27.7	26.7	29.7	31.1
Primary Balance	-3.0	-2.1	-1.1	-0.4
Labor Statistics				
Unemployment Rate (LFS, %)	11.4	9.2	7.5	6.0
Wage Growth *(total economy)*	6.0	8.8	7.0	8.0
External Accounts				
Current Account (% GDP)	0.9	1.4	1.0	0.5
Net FDI (EUR bn)	1.3	1.6	1.5	1.5
FDI / Current Account (%)	Na	Na	Na	Na
FX Reserves (EUR bn)	16.5	20.3	21.0	22.5
Domestic Credit	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	72.3	72.9	67.7	57.1
Credit to Enterprises (%GDP)	44.1	43.9	38.1	34.9
Credit to Households (%GDP)	21.8	21.7	21.0	20.8
FX Credit/Total Credit (%)	63.1	59.8	54.3	50.6
Private Sector Credit (yoy)	3.0	0.2	-8.2	-1.2
Loans to Deposits (%)	99.4	92.1	84.2	78.2
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate		Currency Board		
EUR/BGN	1.96	1.96	1.96	1.96

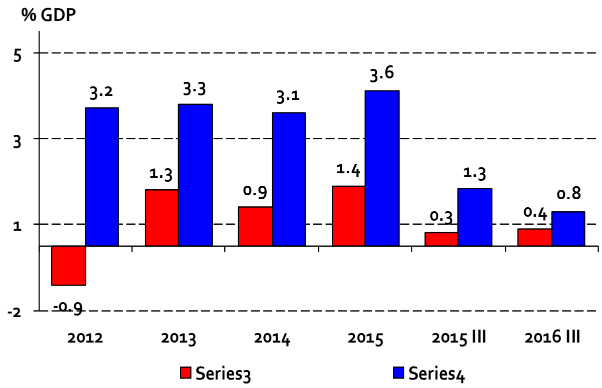
Source: National Sources, Eurostat, IMF, Eurobank Research

FIGURE 13: **GDP growth & Inflation 2000-2016**



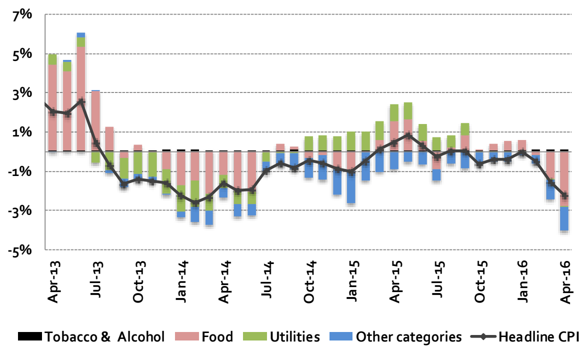
Source: National statistics, Ecowin Reuters, Eurobank Research

FIGURE 14: **CA Deficit & Net FDI inflows 2010-2016**



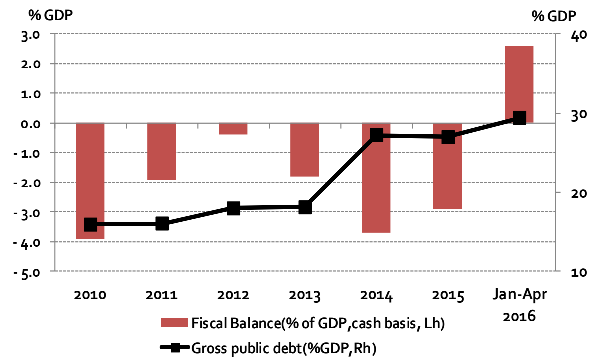
Source: National statistics, Ecowin Reuters, Eurobank Research

FIGURE 15: **Inflation dynamics 2013-2016**



Source: National statistics, Ecowin Reuters, Eurobank Research

FIGURE 16: **Fiscal deficit & Gross Public Debt 2010-2016**



Source: Eurostat, Eurobank Research

Cyprus ((P)B3/BB-/B+)

Parliamentary elections result in a more fragmented new parliament

A more fragmented new parliament emerged from the elections in the Republic in May 22nd

Despite the heightened electoral threshold (3.6% vs. 1.8% previously) and one of the lowest voters' turnout in the history of the Republic-the abstention rate was 32.6%- eight parties entered the new parliament. The ruling right-wing party DHSY gained 37.6% of the vote (18 seats), the main opposition left-wing party AKEL gained 25.7% (16 seats), and DHKO gained 14.5% (9 seats). Five other smaller parties, EDEK (6.2%, 3 seats), Citizens Alliance (6.0%, 3 seats), Solidarity (5.2%, 3 seats), Green Party (4.8%, 2 seats) and far right-wing ELAM (3.7%, 2 seats) were allocated a number of 13 seats compared to only 8 in the previous elections in 2011. The parliamentary elections results are not a game changer as the system of the Republic is presidential and thus they have no direct impact on the formation of the government. Nevertheless, elections are still considered a crucial test for the popularity of the incumbent President Anastasiades whose term is set to expire in 2018. At first sight, it appears that the casualties for the ruling party are low yet not negligible. Even though DHSY was first in popular support, it still lost 3.5 ppts off their electoral base. However, their major opponent lost more than 7 ppts. A large part, if not all, of DHSY's lost votes were leaked to the Solidarity party whose leader was a former Euro parliament MP of DHSY. On the other hand, the ruling party will be more dependent on smaller parties to pass legislation in the parliament. As the next Presidential elections will be approaching, it is also highly likely that the new parliament is going to be less friendly to the ruling party than the outgoing. This is not very reassuring given that there is a number of important pending structural reforms of the economic Adjustment Program that need to be finished in order to avoid a backtracking of the Cypriot economy. Unfinished structural reforms include privatizations, public and health sectors reform, actions to address the challenges of a still high NPLs stock together with a still relatively high ELA exposure (€3.2bn in April 2016 or 18.1% of projected GDP, down from €11.4bn in March 2013). From that point of view, the most recent EU assessment report on the national reforms program submitted by the Republic contained a number of recommendations with respect to speeding up the implementation of public sector reform plans, removing bottlenecks that impede the full functioning of the insolvency and foreclosures framework, and enhance access to EU financing tools for SMEs so as to facilitate investments.

The ESI Index in May remained close to the post-Lehman high in April

The ESI Index fell by 2.0 points to 111.3 in May, compared to 113.3 in April vs. 108.9 in March. With the exception of industry, which improved for a second month in a row moving further up in positive territory, all other sub-components of the index deteriorated. The more pronounced decline in expectations came from construction (by 9.6 points) and consumer sentiment (by 4.1 points). Despite the small decline, the ESI index stands still close to its post-Lehman peak recorded in last April. The improvement recorded in the past three years – a total of 43.4 points since April 2013- is the highest in EU-28 in the same period. As of May, the ESI index stands only 6.5 points below its pre-crisis level recorded at 117.8 in August 2007. The distance to the pre-crisis peak is the shortest among any other EU-28 members. Overall, the sentiment improvement is illustrative of the progress of the Cypriot economy in the past three years within the Adjustment Program. Sentiment improvement is one of the key drivers of the consumption rebound taking place and feeds into output growth. After a three year recession in 2012-2014 the economy expanded by +1.6% YoY in 2015 and growth is expected to further gain momentum to +2.5% YoY in 2016. This forecast stands above the most recent EU Commission Spring forecast of +1.7%, as lower energy prices, strong sentiment improvement, the lagged effect from Euro depreciation, the lack of additional fiscal austerity measures and a flourishing tourism sector are expected to provide more support to consumption's recovery and net exports.

The NPEs ratio edged down to 48.4% in March 2016 down from 48.9% in February 2016

The banking system-wide NPEs ratio- a more conservative asset quality EBA methodology, which inflates NPLs numbers by including restructured loans for a probation period of at least 12 months, edged down to 48.4% in March 2016 vs. 48.9% in February2016, still higher than 45.9% in December 2015, and 47.7% in December 2014. The deterioration of recent months in the ratio does not mirror a further rise in the non-performing facilities but rather the ongoing deleveraging, which impacts the denominator. On the other hand, the pace of loans' restructuring, an essential tool for the resolution of NPLs, has picked up. The amount of loans restructured has been on a continuous climbing trend, from €1bn in Q1-2015 to €1.2bn in Q2-2015, to €1.4bn in Q3-2015, further up to €2.3bn in Q4-2015 and €1.9bn in Q1-2016. As a result, a large fraction of the restructured loans falls into the 12-month probation period and are still classified in NPEs (41.3% in Mar2016 vs. 40.8% in Feb2016). On a more positive note, according to the Central Bank data, 78% of the fixed-term loans which were restructured between 1 January 2014 and 31 March 2016 abide by the new repayment schedule agreed as part of the restructuring process.

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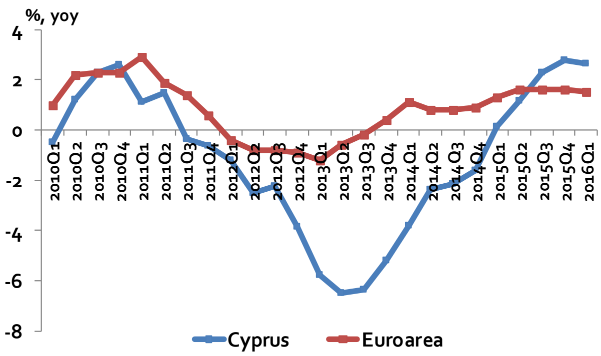
Cyprus: Macro & Market Data	2014	2015	2016f	2017f
Real GDP (yoy%)	-2.5	1.6	2.5	2.7
Inflation (yoy%)				
HICP (annual average)	-0.3	-1.5	-0.7	0.5
HICP (end of period)	-1.0	-1.4	0.2	1.0
Fiscal Accounts (%GDP)				
General Government Balance	-0.2	0.0	-0.4	-0.5
Gross Public Debt	108.2	108.9	105.6	101.7
Primary Balance	2.7	1.8	2.2	1.9
Labor Statistics				
Unemployment Rate (LFS, %)	16.1	15.1	13.4	12.4
Compensation per employee (%)	-3.5	-1.0	1.1	1.4
External Accounts (% GDP)				
Current Account	-4.6	-3.6	-4.2	-4.6
Trade Balance (Goods)	-16.2	-18.4	-18.4	-18.6
Terms of Trade (of Goods)	7.1	2.6	2.2	-0.3
Domestic Credit	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	371.6	351.4	353.5	360.8
Credit to Enterprises (%GDP)	170.2	160.2	148.1	151.5
Credit to Households (%GDP)	138.2	140.0	142.7	136.4
Private Sector Credit (yoy)	6.2%	-12.2%	-2.3%	-3.4%
Loans to Deposits (%)	103.3%	135.3%	133.4%	136.6%

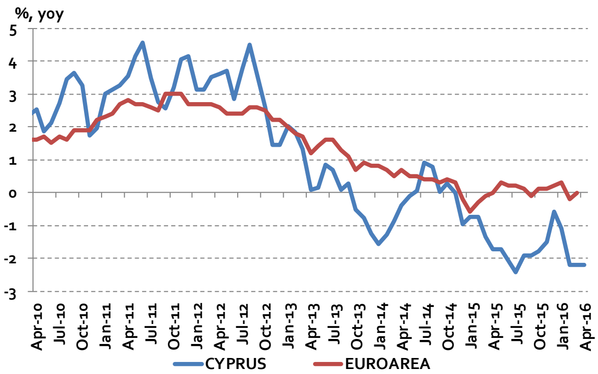
Source: National Sources, Eurostat, IMF, Eurobank Research

FIGURE 17: **Growth performance Cyprus vs. Euroarea 2010-2016**



Source: Eurostat, Eurobank Research

FIGURE 18: **HICP Cyprus vs. Euroarea 2010-2016**

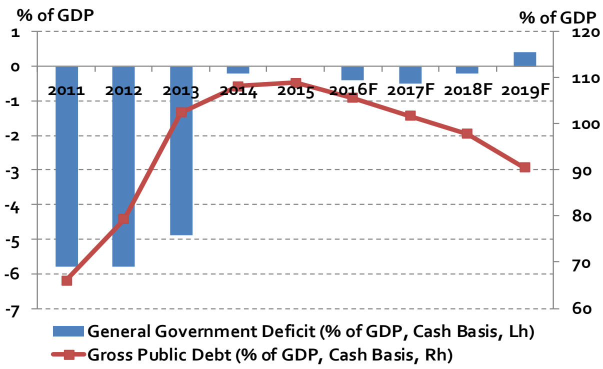


Source: Eurostat, Eurobank Research

FIGURE 19: **10Y Government Bond Yield**

Source: Bloomberg, Eurobank Research

FIGURE 20: **Fiscal deficit & Gross Public Debt 2011-2016**



Source: Ministry of Finance, Eurobank Research

Romania (Baa3/BBB-/BBB-)

Stronger than expected Q1-2016 GDP estimate

The second estimate of the Statistical Service on Q1-2016 real GDP growth confirmed the flash estimate

The second estimate on the seasonally adjusted Q1-2016 GDP reading confirmed the flash estimate of +1.6% QoQ/+4.2% YoY, +4.3% YoY in unadjusted terms, significantly above initial consensus expectations (+1.1% QoQ/+3.9% YoY). The stronger than expected print compares to +1.1% QoQ/+3.9% YoY in Q4-2015, up from +1.5% QoQ/+3.6% YoY in Q3-2015 and +1.2% QoQ/+3.9% YoY in Q1-2015. Both private consumption and gross fixed capital formation posted very strong dynamics. Private consumption jumped by +3.4% QoQ/+9.2% YoY in Q1, making a hefty contribution of 6.6pps to growth. Gross fixed capital formation expanded by +2.3% QoQ/+7.0% YoY, making a 1.3pps contribution to growth, which was only partially offset by the negative contribution of inventories (-0.4pps). On the other hand, net exports made a negative contribution of -3.4pps-mirroring the deceleration of exports (+0.5% QoQ/+1.2% YoY) vs. the robust dynamics of imports (+2.8% QoQ/+8.0% YoY) -which is broadly expected as domestic demand recovery is accompanied by a recovery of imports. Growth is expected to accelerate further to 4.2% in 2016, up from 3.8% in 2015. However, growth dynamics are driven by a private consumption spending boom, fuelled by the unwarranted pro-cyclical fiscal stimulus ahead of the parliamentary elections scheduled for late 2016. Hence, the economy is driven close to, if not above, its potential growth rate at the expense of pushing government finances off consolidation track.

Budget execution in the first four months of the year highlights the risk of fiscal slippage in an election year

The consolidated government balance in cash terms recorded a negligible surplus of RON127mn or 0.02% of projected GDP in January-April 2016, down from a surplus of RON5.96bn or 0.8% of GDP in the same period of 2015. The budget recorded a very poor result in April, a deficit of RON2.9bn only compared to a surplus of RON1.1bn in April 2015. The poor budget performance in April alone was the combined result of a contraction in total revenues (-2.8% YoY) coupled with an acceleration in total expenditure (+5.3% YoY). The slump in total revenues was driven by lower VAT revenues (-28.7% YoY in April, double than the yearly contraction of March) mirroring the impact of the headline VAT rate cut by 4ppts effective from January1st. In addition, the collapse of EU funds inflows (down by 87.7% YoY to RON 313.9mn in Jan-Apr) as a result of the closing of the previous program period weighted further negatively. On the other hand, total expenditure spiked by +5.3% YoY in January-April 2016 driven by the generous wages increases in the public sector. Staff costs were up by +8.4% YoY reflecting the generous wage hikes for all public sector employees and the rise of the minimum wage. Pension expenses were also up by +7.3% YoY in the same period. The overly expansionary fiscal policy threatens to push the fiscal deficit in cash terms above the 2.8% of GDP target (2.95% in ESA2010 terms) in 2016 and further above the 3% threshold in 2017.

Another downside surprise occurred on the inflation front in the fourth month of the year.

Inflation edged even lower to -0.15% MoM/-3.3% YoY in April, down from +0.1% MoM/-3.0% in March compared to -0.2% MoM/-2.7% YoY in February-a new historic low. The print was below market expectations again (BBG survey: +0.2% MoM/-2.9% YoY).The implementation of a 4ppts headline VAT rate cut -from 24% to 20%- effective from January 1st, compounded by the food staff VAT rate cut -from 24% to 9% effective from last June- has pushed headline inflation further into negative territory. On a monthly basis, softer developments in the food and energy components of the consumer basket were the main culprits behind headline inflation decline, as has been the case also in recent months. The volatile food component of CPI declined to -0.4%MoM/-7.4%YoY down from 0.01% MoM/-6.7% YoY in March. Non-food items edged down to -0.1% MoM/-1.0% YoY in April compared to +0.2% MoM/-0.9%YoY in March. Services inched up to +0.1% MoM/-0.4% YoY in April compared to -0.01% MoM/-0.5%YoY in March.

Despite the energy prices slump and the negative base effects from fiscal easing, underlying inflationary pressures are rising in Romania faster than its peers.

Overall, given the downbeat readings in the first months of the year, inflation trajectory so far has been softer than envisaged before. In the NBR's view, inflation is expected to stay in negative territory until July and then gradually move up. According to the updated NBR report, the baseline scenario envisages the inflation rate gradually returning inside the variation target band (2.5% +/-1%) and standing in the upper half of the band at the end of the forecast horizon in Q4-2017. As a result, NBR slashed its year-end inflation forecast in 2016 to +0.6% YoY vs. +1.4% YoY in the February inflation report compared to +1.0% YoY in that of November. The NBR Governor, Mugur Isarescu, had explained in the most recent press conference after the policy meeting that the transitory effects of the headline VAT rate cut and of other indirect tax cuts, as well as the announced reduction of several administrative prices in energy, were the main reasons behind the revision. In any case, despite the energy prices slump and the negative base effects from fiscal easing, underlying inflationary pressures are rising in Romania faster than its peers. HICP at constant taxes came at +2.2% YoY in April vs. 2.4% YoY in March, significantly higher than its regional peers (Poland: -0.5% YoY, Hungary: +0.4% YoY, Bulgaria:-2.6% YoY).

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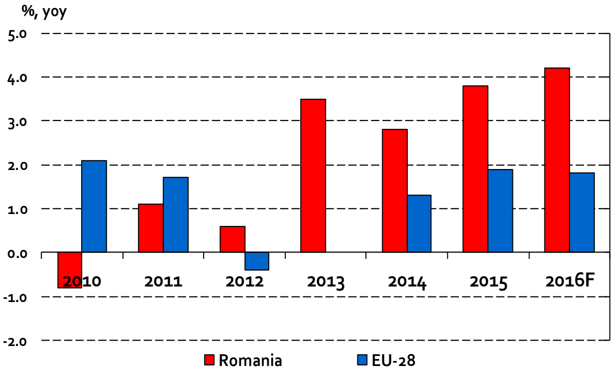
Romania: Macro & Market Data				
	2014	**2015**	**2016f**	**2017f**
Real GDP (yoy%)	2.9	3.8	4.2	3.5
Inflation (yoy%)				
CPI (annual average)	1.1	-0.6	-1.5	2.5
CPI (end of period)	0.8	-0.9	0.4	3.4
Fiscal Accounts (%GDP, Cash Basis)				
General Government Balance	-1.9	-1.9	-2.8	-3.7
Gross Public Debt (including guarantees)	39.5	39.1	40.5	42.6
Labor Statistics (annual avg,%)				
Unemployment Rate (ILO, % of labor force)	6.8	6.7	6.5	6.3
Wage Growth (total economy)	7.6	8.4	12.5	5.0
External Accounts				
Current Account (%GDP, BPM5)	-0.4	-1.1	-3.0	-3.2
Net FDI (EUR bn)	2.5	2.7	3.0	3.5
FDI / Current Account (%)	385.0	157.1	58.8	60.8
FX Reserves (EUR bn)	32.2	32.2	33.5	32.0
Domestic Credit *(end of period)*	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	52.0	47.0	44.4	43.9
Credit to Enterprises (%GDP)	20.3	18.0	15.7	15.5
Credit to Households (%GDP)	17.8	16.5	15.4	15.4
FX Credit/Total Credit (%, private)	62.5	60.9	56.2	49.3
Private Sector Credit (yoy)	1.3	-3.3	-3.1	3.0
Loans to Deposits (%)	133.9	118.4	106.3	106.6
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate	1.75	1.75	1.75	2.00
EUR/RON	4.53	4.55	4.60	4.35

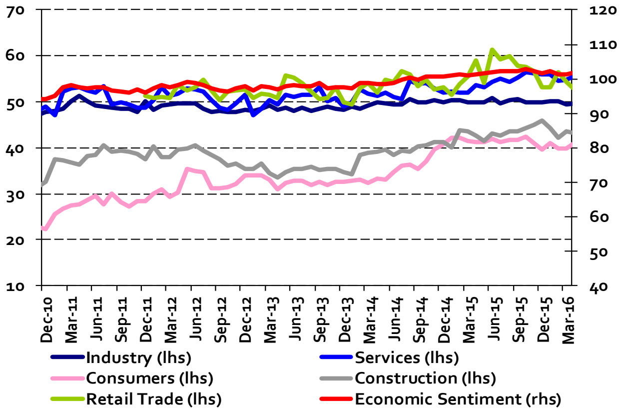
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 21: **Growth performance Romania vs. EU28 2010-2016**



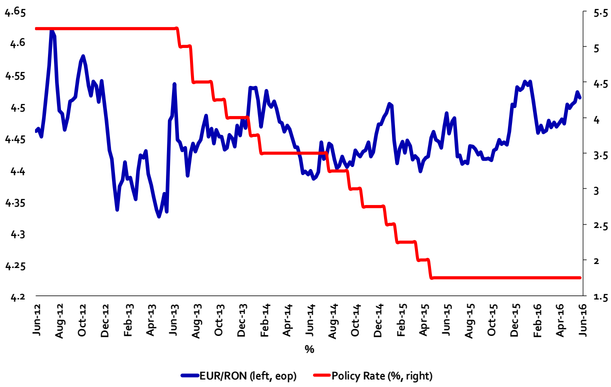
Source: Eurostat, Eurobank Research

FIGURE 22: **Sentiment indicators 2011-2016**



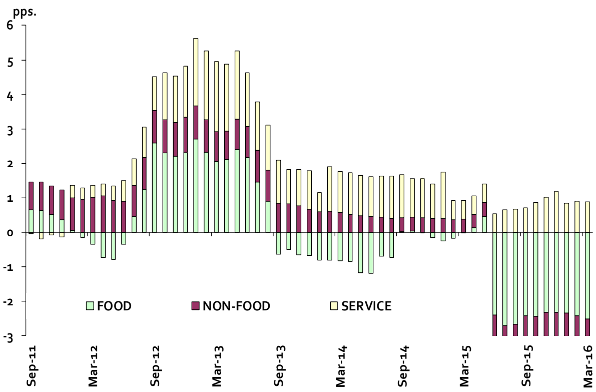
Source: Eurostat, Ecowin Reuters, Eurobank Research

FIGURE 23: **Monetary policy & FX rate 2012-2016**



Source: Bloomberg, Eurobank Research

FIGURE 24: **Inflation components 2011-2016**



Source: National statistics, Eurobank Research

Serbia (B1/BB-/B+)

Economic activity picks up further pace, led by investments and exports

Q1 2016 real GDP growth confirmed at 3.5%YoY, marking the highest annual rate of increase since Q4 2013

According to final data by, real GDP growth for Q1 2016 was confirmed at 3.5%YoY. This marks a significant acceleration from a 1.2%YoY increase a quarter earlier and also compares favorably with a contraction of 1.8%YoY over the same period of 2015. This performance reflects the ongoing improvement in domestic economic activity after the 2014 floods; it is the highest annual rate of increase since Q4 2013 and the fourth consecutive quarter with a positive annual growth rate. The breakdown of the data revealed a broad-based improvement in nearly all sectors of the economy. From the production side, financial and insurance activities were the only exception to reveal some slowdown (to +1.6%YoY from +3.8%YoY in Q4 2015). Favorable base effects seemed to bear a significant impact, with agricultural production rising by 3.0%YoY after a contraction of -6.6%YoY in Q4 2015 and -8.4%YoY in Q1 2015. A similar picture was witnessed from the expenditure side with all categories staging a further recovery. In line with our expectations, investments and exports remained the main engines of economic activity. Gross fixed capital formation remained robust, rising by 7.9%YoY, a tad faster from a 7.8%YoY in the last quarter of the prior year. Meanwhile, exports' growth of 11.5%YoY more than doubled from 5.5%YoY in Q4 2015, mostly thanks to the positive impact of 2015 investments, a large part of which targeted medium-size export-oriented enterprises. On the flipside, imports posted a simultaneous growth of 4.7%YoY (+5.1%YoY in the October-December 2015 period), which possibly reflected lower energy imports in view of the decline in global commodity prices. Following nine consecutive quarters of annual declines, household expenditure rose by 0.7%YoY in Q1 2016. Meanwhile, government consumption growth also picked up pace coming in at 3.2%YoY from 0.8%YoY a quarter earlier despite ongoing fiscal consolidation, possibly on increased infrastructure-related spending.

Economic activity expected to accelerate to ca 2.0% this year from 0.7% in 2015

All in all, the data confirmed that last year's positive trends seem to have continued into early 2016. Higher frequency data for January-April also appear supportive of the aforementioned. Industrial production growth and retail trade turnover both remained robust (+9.9%YoY each). External trade also continued to improve in the first four months of the year, with the corresponding deficit narrowing by 19.1%YoY, as exports rose (+11.9%YoY) much faster than imports (3.4%YoY). For the whole of the year, real GDP growth is expected to accelerate to around 2.0% from 0.7% in 2015. Investments are anticipated to continue leading the recovery in view of improving business climate and higher public capital expenditure. Lower primary commodities prices are also likely to continue favoring gross fixed capital formation as well as private spending. Cheaper debt servicing costs, amid lower interest rates, and subdued inflation pressures also appear poised to provide an additional lift to disposable income. Growth in private consumption is expected to pick up further pace as the impact of fiscal consolidation wanes and private sector employment recovers. On the other hand, the net exports' contribution will likely become more neutral as the recovery in domestic demand backs a concomitant growth in imports.

Budget execution for the January-April period continued to outperform expectations

With regards to the latest developments on the fiscal front, budget execution for the 4M period came in better than expected. The consolidated general deficit amounted to ca. RSD 25bn over the said period, just 15% of the full year budgeted deficit of RSD 164bn (EUR 1.33bn). This solid performance comes thanks partly to several one offs, such as the auctioned sale of the mobile 4G licenses to telecoms, which brought RSD 12bn in the government's coffers and savings due to the postponement of severance packages payoffs in the public sector for RSD 5bn. Still, tax collections also improved, in part because of the acceleration in retail trade turnover in the four month period.

Discussions for the formation of a new government to continue in coming weeks

Prime minister designate Aleksandar Vucic and his Serbian Progressive Party (SNS) ended the first round of coalition talks with other parliamentary groups, but Mr. Vucic fell short of giving any detail on the new alliance, saying that deliberations will continue in the weeks to come. The Socialist Party of Serbia led by Foreign Minister Ivica Dacic still figures as the main candidate although there is speculation that the pro-EU Liberal Democratic Party (LDP) is also among possible hopefuls. Although it may not seem vital at the moment, as the Progressives command the simple majority of seats in the Assembly (131 of 250 seats), the minor partner will provide the flavor of the new administration in respect to leaning towards the EU or Russia. Economic policies are likely to remain intact as all major contenders agree on the agenda as drafted within the IMF 3-year precautionary Stand-By Arrangement in place.

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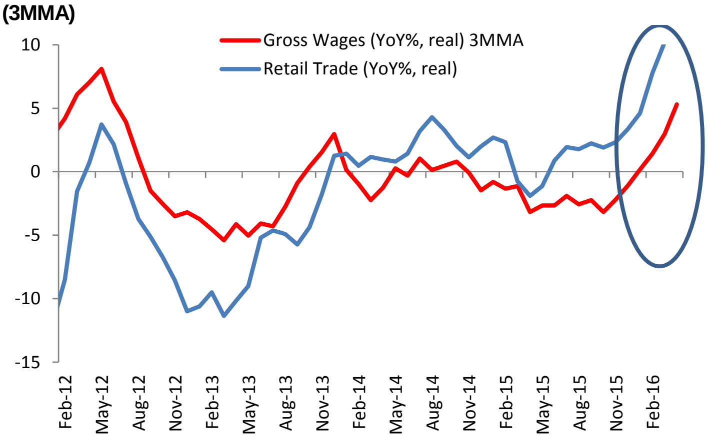
Serbia: Eurobank Forecasts

	2014	2015	2016	2017
Real GDP (yoy%)	-1.8	0.8	1.8	2.2
Inflation (yoy%)				
HICP (annual average)	2.1	1.5	2.8	3.9
HICP (end of period)	1.7	1.5	3.5	3.8
Fiscal Accounts (%GDP)				
Consolidated Government Deficit	-6.7	-4.1	-4.0	-2.6
Gross Public Debt	72.2	75.9	75.5	76.0
Labor Statistics (%)				
Unemployment Rate (%of labor force)	19.4	17.7	17.7	17.0
Wage Growth *(total economy)*	2.0	0.0	0.0	0.0
External Accounts				
Current Account (% GDP)	-6.0	-4.7	-4.6	-4.3
Net FDI (EUR bn)	1.2	1.6	1.6	1.5
FDI / Current Account (%)	60.0	106.7	100.0	100.0
FX Reserves (EUR bn)	9.9	10.4	11.0	10.6
Domestic Credit	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	62.8	57.0	61.5	63.6
Credit to Enterprises (%GDP)	31.2	26.1	25.0	25.0
Credit to Households (%GDP)	18.2	17.4	18.7	19.6
Private Sector Credit (yoy%)	9.5	-4.8	0.5	3.2
Loans to Deposits (%)	126.9	114.1	111.8	112.6
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate	4.25	4.25	4.25	4.25
EUR/RSD	123.30	124.00	125.00	127.00

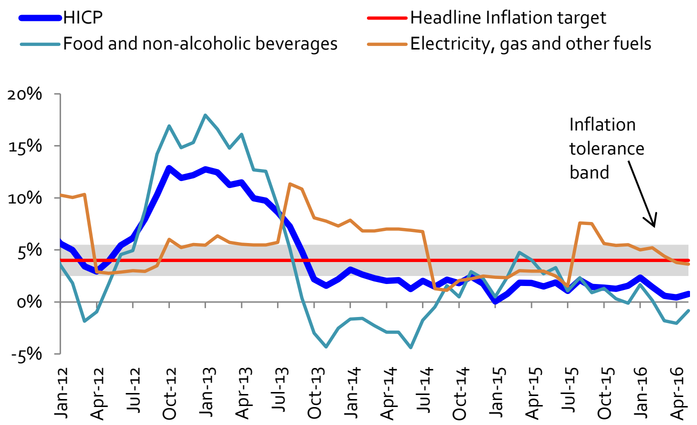
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 25: **Recovery in private consumption and wage growth continues (3MMA)**



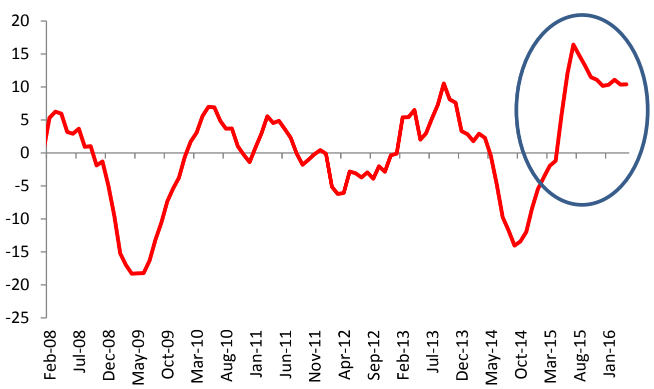
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 26: **Inflation remains below NBS target for two years**



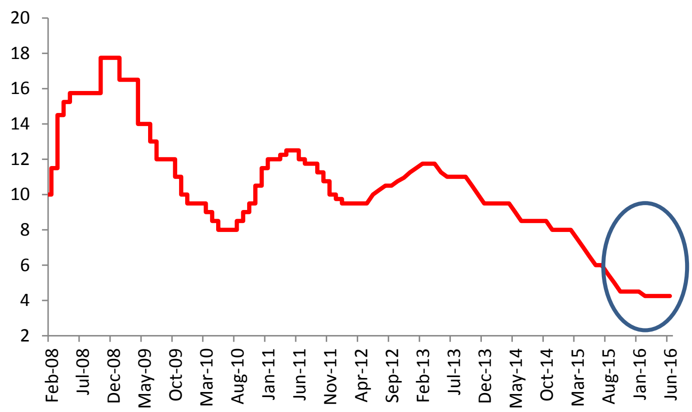
Source: National Authorities, Eurobank Research

FIGURE 27: **Growth in industrial production remains robust in Q1 2016 (3MMA YoY %)**



Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 28: **NBS holds fire for 4th month running in June**



Source: National Authorities, EC, IMF, Eurobank Research

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